

May 1, 2007

HONORABLE MAYOR AND CITY COUNCIL:

I am pleased to present the *2007-2008 Proposed Operating Budget*, a fiscal roadmap for San José that recommends new resources for some key City Council priority areas, closes a projected \$16 million budget gap, and sets the groundwork to begin addressing the long-term structural deficit that has been much-discussed by the Mayor and City Council. This Proposed Budget also reflects the new budgeting process established by the City Council when it approved the Reed Reforms at its first meeting in January, 2007.

In formulating these proposals, the Administration has prioritized the emerging needs of the City as identified by the City Council, while maintaining a conservative fiscal approach that has allowed San José to sustain the highest bond rating of any large city in California. A careful reading of the 2007-2008 Proposed Operating Budget will reveal the strategic addition of resources to address some critical service and infrastructure needs. Among these are recommendations that address public safety needs, staffing in our community centers and aquatics facilities, as well as some key strategic support areas where earlier reductions have significantly restricted the ability of certain key departments to support the organization.

Adding resources in a few key areas was not accomplished in this proposal without some cost. The City continues to face significant long-term fiscal challenges, and the list of unmet needs includes significant levels of infrastructure maintenance that will remain largely unaddressed for another year. While our local economy has clearly recovered from the lengthy and powerful recession that began in 2001, any significant growth in economically sensitive revenues appears to have leveled off with some key indicators now showing signs of weakness. And despite the improved picture from five years ago, we now face a sixth consecutive year with a multi-million dollar General Fund deficit and the 2008-2012 General Fund forecast projects continuing deficits into the future. Put simply, the cost of continuing the current level of service will not be sustainable in the future absent new sources of revenue, and/or a reduction in costs. As a result, the City of San José must confront the need for significant budget reductions.

The City Council addressed this issue at its February Priority Setting Study Session when it established the elimination of the structural deficit as one of five 3-year goals. This Proposed Budget makes progress in this regard by closing 94% of this year's General Fund deficit with ongoing funding solutions, thus reducing the negative impact on future budget years that occurs when one-time dollars are used to address ongoing needs.

2007–2008 PROPOSED BUDGET MESSAGE

While San José's overall fiscal condition remains sound, and the local economy shows encouraging signs in some areas such as job growth and the unemployment rate, other recent indicators must give pause to all but the most conservative assumptions about future revenues. While economically sensitive revenue sources will meet projections for the current year, the City's second largest revenue source, Sales Tax, has not experienced any growth in the first half of 2006-2007. Further, the slowing housing market poses twin threats, both to Property Tax and Sales Tax revenues. Property Tax revenues fall with the declining price of home sales, and Sales Tax dollars could decline as spending on construction materials slows along with consumer spending that has been fueled until now by the appreciation in housing prices.

While these are worrisome indicators, overall we are able to project moderate growth in revenues for the coming year. The recommendations in this budget are based on the underlying assumption that the economic environment in the region will return neither to the high growth levels of the late 1990s nor the recession conditions in the first four years of the decade. While the Valley economy and the associated City revenue performance are expected to maintain modest growth, as noted earlier, we must include a reminder that expenditure levels simply to maintain existing General Fund programs will exceed those revenue growth rates.

NEW BUDGET PROCESS

Despite the ongoing fiscal challenges, the recommendations in this Proposed Operating Budget continue to focus on City Council priorities, directing resources toward essential services, basic infrastructure requirements, economic development opportunities, and maintaining the City's strong commitment to neighborhoods.

The City embarked on a new and markedly different public process leading up to the creation of this proposal. Following passage of the Reed Reforms in early January, a telephone poll of 450 residents was conducted in English, Spanish and Vietnamese. The results showed that a majority of residents believe the City is currently spending the right amount of money in key service areas. If additional money was available, those surveyed would prefer that new dollars be targeted for police services and street maintenance and repairs. The survey also showed that a significant number of residents were unwilling to cut funding in one area to enhance services in another. Immediately following the telephone survey, a neighborhood association budget priority setting session was held on a Saturday. More than 100 neighborhood leaders attended the facilitated session, identifying five key priorities:

- Increase the number of jobs in the City of San José;
- Improve proactive code enforcement;
- Provide full funding for parks, pools, community centers and libraries, including maintenance and operations and development;
- Improve community policing in the neighborhoods; and
- Improve General Fund revenue.

Following these extraordinary community outreach efforts, the City Council, Council Appointees, and Senior Staff met in a full day Council Priority Setting Study Session. Building upon the input received from both the survey and neighborhood meetings, five priorities were identified as 3-year

2007–2008 PROPOSED BUDGET MESSAGE

NEW BUDGET PROCESS (CONT'D.)

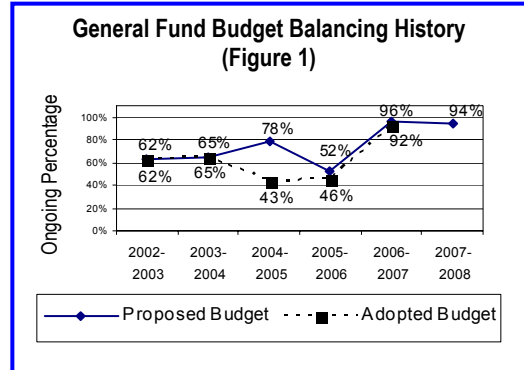
goals for the City. A number of budget actions that support and advance the five goals are identified in the table below, along with a summary of related actions:

3-Year Goal	Proposed Budget Actions
Maintain our status as the safest big city in America	<ul style="list-style-type: none">• Adds 15 police officers and protected all core patrol functions.• Restores emergency dispatch supervisor position.• Adds 13 fire positions for new Station 34.• Adds a Battalion Chief for special operations training.
Eliminate the structural budget deficit	<ul style="list-style-type: none">• Establishes a foundation for the future elimination of the structural budget deficit by maximizing the use of ongoing dollars to close this year's budget deficit, thereby minimizing the impact on future year budgets.• Establishes \$2 million reserve to begin addressing the City's GASB 43/45 liability for future benefits.• Sets in motion a process to engage employees, who must be partners in reducing costs, to identify and craft cost-reduction strategies.
Reduce deferred maintenance and the infrastructure backlog and develop a strategy to improve the infrastructure	<ul style="list-style-type: none">• Restores park maintenance funding.• Establishes \$5 million in one-time funding for street infrastructure maintenance.• Sets aside \$5.5 million in one-time funding for technology infrastructure upgrades.• A community engagement process is underway to develop a Transportation Maintenance Master Plan to develop funding priorities for maintenance and discuss funding strategies.
Increase economic vitality	<ul style="list-style-type: none">• Establishes an Economic Incentive Fund to that would be available to provide incentives for extraordinary and unanticipated development activities to ensure creation of new jobs in San José.• Provides funding to contract for additional public relations services to continue building the San José brand in national and international markets.• Provides funding for international air service development.
Provide full funding for parks, pools, community centers and libraries, including maintenance, operation and development	<ul style="list-style-type: none">• Adds 12 positions plus funding for utilities, custodial and preventive maintenance for new parks and recreation facilities.• Restores aquatics positions and funding to support operations at four school-leased pool sites.• Adds 22 positions for Northside Community Center, Alma Senior Center, Hank Lopez Youth/Community Center, St. James Senior Center, and the remaining 17 re-use sites.• Adds funding to make permanent 9 temporary therapeutic staff positions at Grace Community Center.

2007-2008 PROPOSED BUDGET MESSAGE

STRUCTURAL DEFICIT & UNMET NEEDS

As noted above, 94% of the \$16 million budget shortfall has been closed in this Proposed Budget with ongoing dollars, a significant improvement over the past five years of deficit closing actions, as Figure 1 demonstrates. Should the City Council wish to close the current deficit with only ongoing dollars, an additional \$1,262,000 in cuts would be required. A strict adherence to the policy of funding ongoing programs and services with only ongoing dollars is an important goal. However, in the context of a \$900 million operating budget, experience has demonstrated a consistent surplus year-end balance of several million dollars. Therefore, it is the Administration's belief that the use of \$1.3 million in one-time dollars (.14% of the operating budget) to close the current deficit still meets the test of sound fiscal principles. Nevertheless, the Administration has evaluated additional reductions that could be imposed to meet the 100% goal. While these are not recommended, they are included in Table 1, should the City Council wish to pursue further reductions.



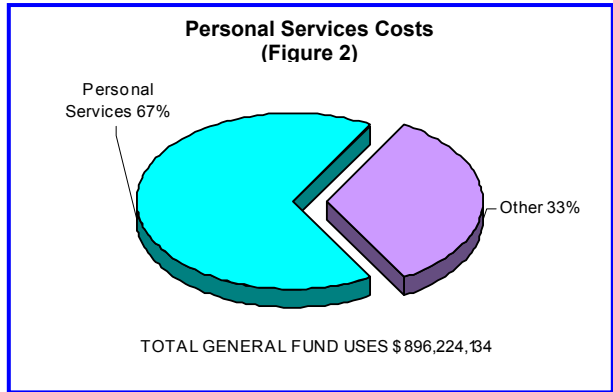
Additional Reductions Not Recommended (Table 1)	
Eliminate Proposed Additions	
2 New General Code Enforcement Inspector Positions	(197,292)
Eliminate ADA Coordinator	(172,040)
Eliminate Return to Work Coordinator	(126,163)
Subtotal	(495,495)
Additional Program Reductions	
Elimination of Hose Wagon 6	(439,285)
Summer Youth Employment Program	(232,788)
Youth Commission Support	(85,289)
Subtotal	(757,362)
Total	(1,252,857)

Our ability to sustain services throughout the recession and slow recovery has rested on the conservative fiscal policies adhered to by the City Council and the organization over the past five years. As we have in years past, this year the Administration continued a Cost/Position Management Plan to reduce the impact of the projected shortfall in the General Fund. This plan required every General Fund department to meet a savings target in the current fiscal year. This effort resulted in additional savings of \$4.2 million to help balance the 2007-2008 Proposed Budget. We also continued the freeze in hiring for non-critical positions, first imposed in 2001 with the desired effect of reducing expenditures and preserving vacancies to avoid layoffs. While the number of City employees remains down from a high of nearly 7,500, the 6,970 positions included in the 2007-2008 Proposed Budget, represents a net increase of 127 positions to address the City Council's priorities in Public Safety and Neighborhood Services and to shore up critical staff in key Strategic Support departments.

2007–2008 PROPOSED BUDGET MESSAGE

STRUCTURAL DEFICIT & UNMET NEEDS (CONT'D.)

As noted above, the City continues to confront a structural problem in the General Fund with expenditures exceeding revenues in each year of the Five-Year Forecast. As is well-understood by this City Council and by anyone familiar with municipal budgeting, the largest portion by far of General Fund dollars goes to pay for the salaries and benefits of City employees. As shown in the Personal Services Costs chart (Figure 2), two-thirds of General Fund expenditures are directly tied to personnel costs. The challenge in reducing personnel costs is exacerbated by the fact that fully 64% of the personnel costs (Figure 3) are in Public Safety, a priority area in which it is always difficult to make reductions. Together, these two charts demonstrate the dilemma facing San José. The cost of simply continuing the current level of services pushes higher each year, driven



partially by cost of living increases, but more by the cost of providing health and retirement benefits. An added concern is that with one-third percent of our employees reaching retirement eligibility within the next five years, the City must remain competitive in attracting new talent—yet another upward pressure on the budget.

Approximately 230 new positions are proposed for addition in this budget from the Forecast Base Budget level. The targeted additions are concentrated in several key areas, such as:

- **Public Safety**, with the addition of 15 new Police Officers, per direction in the Mayor's March Budget Message, and 13 new positions to staff Fire Station 34;
- **Neighborhood Services**, with 22 positions for the proposed Community Center Re-Use plan, 9 positions for aquatics programming needs, 9 positions for the conversion of Grace Community Center staff to City staff, and 12 new positions for operations and maintenance needs for new recreational facilities, such as Lake Cunningham Skate Park and two new dog parks;
- **Strategic Support**, with recommended additions for the Customer Contact Center (19 positions) and financial and technical positions (8 positions) to support the Integrated Billing System, Human Resources, where improvements to the Workers' Compensation Program (6 positions) and recruitment efforts (3 positions) are recommended, and Finance, where new initiatives such as the Revenue Collection Strategic Plan (5 positions) and an aggressive encumbrance liquidation project (1 position) are recommended.

While the positions above are recommended for funding in the General Fund, other strategic additions are recommended to be funded by special or capital funds. The Development Fee

2007-2008 PROPOSED BUDGET MESSAGE

STRUCTURAL DEFICIT & UNMET NEEDS (CONT'D.)

Programs are included in this category as well. Key position changes funded from sources other than the General Fund include:

- **Transportation**, where 19 new positions are recommended to implement improvements programmed in the Traffic Capital Program;
- **Airport**, where 5 new positions are recommended for maintenance and operations needs associated with Terminal A+;
- **Development Services**, with developers reimbursing the City for the cost of 9 positions to review plans and perform inspection services associated with new development; and,
- **Water Pollution Control Plant**, where 22 new positions are recommended to implement an aggressive maintenance and infrastructure improvement plan.

While this current proposal and the Five-Year Forecast demonstrate the City's ability to continue essentially limping along at current levels, the more profound concern is our ability to address the long Unmet Needs List that looms large and presents almost unavoidable expenditure increases in the future. These fall into two categories: 1) Unmet/Deferred Infrastructure and Maintenance Needs; and, 2) New and Unfunded Initiatives/Programs. A small number of the most critical current year needs on this list, which is attached as Appendix 1, are addressed in this Proposed Budget. However, the larger list presents an unavoidable fiscal challenge. Just looking at the \$20 million necessary to implement the first tier of the police staffing plan, and the \$390 million necessary to meet our transportation infrastructure needs illustrate the challenge. The City simply must identify revenue shifts and alternative funding mechanisms such as assessment districts or bond measures on the capital side to free up dollars for the General Fund. The community expectations for public service would not sustain the \$20 million reduction in non-Public Safety areas that would be required to fund the Police Staffing Plan in 2007-2008.

The only way to address the long term and enduring structural deficit is to increase revenues or decrease the cost of employees. The largest single budgetary impact in the foreseeable future is the effect of GASB 43/45, which changes accepted accounting rules for the public sector when addressing future retirement liabilities. While San José is better off than most local governments due to its historically conservative approach to funding the full cost of retirement obligations in each budget and Five-Year Forecast, the cost of the GASB 43/45 accounting change is still projected to be in the range of \$100 million annually (all funds), to fully fund both the outstanding liability and the obligation going forward. A \$2 million down payment on this future obligation is included in this proposal.

All of the expenditure management actions implemented in past years have been continued through 2006-2007. In addition to the Hiring Freeze and Cost/Position Management plans cited above, we have continued expenditure controls on technology, marketing and vehicle purchases first imposed in 2003, and have continued to offer a Voluntary Furlough and Special Reduced Work Week program, which this year saved \$1 million in all funds.

2007-2008 PROPOSED BUDGET MESSAGE

STRUCTURAL DEFICIT & UNMET NEEDS (CONT'D.)

In recent years San José has been very prudent in its use of reserve funds, and it is important to note that this cautious approach is one of the key factors that has allowed San José to sustain a strong AA+ bond rating. This rating is still the highest of any major California city and has translated directly to the City's bottom line by keeping interest rates low when we borrow money.

The historically cautious approach to budgeting that San José has maintained for the past six years must be sustained for the foreseeable future. Absent a dramatic change in our revenues or costs, we should continue to act prudently and dedicate one-time funding to meeting two critical needs: 1) infrastructure maintenance costs that continue to grow significantly; and, 2) emergency reserves to address GASB and other unmet needs that will challenge the City's ability to maintain our hard-earned credit rating. As noted above, the City Council will find recommendations for the use of one-time dollars to set aside funds to address critical needs in several of the 3-Year Goals established in its Council Priority Setting Study Session. A full review of the City's current and projected fiscal picture is detailed in the *General Fund Balancing Strategy Detail* (Attachment A).

ECONOMIC PERFORMANCE

As is the case every year, the most significant challenge the Administration faces in formulating a budget for the coming year is projecting the condition of the local economy and the associated revenue collections. For the 2007-2008 Proposed Budget, the revenue estimates have been built on the assumption of continued modest economic growth at the national, State and local levels, with some impacts associated with the slowdown in the housing market. A brief discussion of the economic outlook in those areas is included below.

National/California Outlook

Consistent with the primary economic forecasting data we rely on, revenue estimates in the Proposed Budget assume that the U.S. economy will continue to grow, but at a slower rate in 2007 primarily as a result of the housing market slowdown. The UCLA Anderson Business School forecast predicts, for example, that 2007 economic growth will be lower than the average of what has occurred for the last several years. The 2006 edition of *California Economic Growth* issued by the Center For Continuing Study of the California Economy echoes this, predicting "Economic growth in 2007 should be slower than in 2006. A housing slowdown has begun and should continue into next year. This will restrain job growth and consumer spending." Consistent with that view, recent financial reports by the country's largest corporations have shown slowdowns in profit growth. As profits fall, employment declines are usually not far behind. Interest rates are also inching upward as the result of inflation fears and a falling dollar. Rising interest rates have historically made it more difficult for people to buy cars and other big-ticket items as well as held down housing growth.

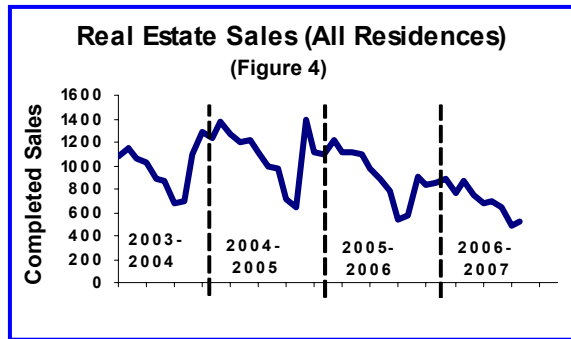
Despite these problems, current unemployment rates remain relatively low for the nation, State, and region lending support to the view that although reduced, modest State and national economic growth will continue. In addition, high tech, aerospace, defense and agriculture, all important sectors of the State economy, continue to experience slight gains.

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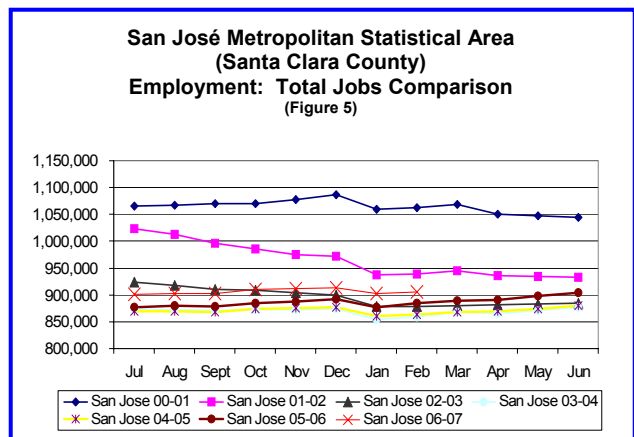
ECONOMIC PERFORMANCE (CONT'D.)

City of San José Outlook

As stated above, we believe the slowdown in the housing market being experienced nationally will also continue to affect this region. For San José, the slowing housing market can directly and negatively impact a number of the City's larger revenue sources, including Property Taxes and Construction and Conveyance Taxes. The slowdown in this area can also indirectly impact Sales Tax collections with the downward spending in construction materials and the reduction of consumer spending as the "wealth effect" associated with housing appreciation diminishes. As shown in the chart (Figure 4), the number of housing sales has dropped significantly in the last year.



While the housing market continues to present challenges, employment in the area has now stabilized and shown slight gains. Job growth in the last year included the addition of 6,100 jobs in the professional and business services sectors, continuing a two-year trend of year-over-year job gains. That expansion "is the most exciting and positive part of the news," said Stephen Levy, director of the Palo Alto-based Center for Continuing Study of the California Economy. "Professional services are where the job growth in the high-tech sector had been for a long time. It was a beginning sign that the high-tech sector overall and the venture capital sector overall was recovering."



While the job growth news is positive, it should be noted that the number of jobs in this region is still 180,000 below the peak of 1.1 million in December 2000 (Figure 5). Between this peak and the low point in January 2004, approximately 232,000 jobs were lost. Of this amount, 51,400 (22%) have been added back, bringing the total number of jobs to 905,800.

In addition to the slight gains in job numbers, the local unemployment rate remains relatively low. The February unemployment rate for the San José area (unadjusted) was 4.6%, down slightly from 4.7% in January 2007 and below the February 2006 level of 5.0%. The February 2007 results for this area were slightly below the unadjusted figures for the State (5.2%) and the nation (4.9%). Staff will continue to carefully monitor employment levels for indicators of any economic slowdown from the modest growth levels assumed in this budget.

2007–2008 PROPOSED BUDGET MESSAGE

ECONOMIC PERFORMANCE (CONT'D.)

While modest economic growth has been anticipated in formulating 2007-2008 revenue estimates, it is important to remember that when analyzing the City's General Fund revenues, only about half of the categories are tied directly to the performance of the economy. The remaining areas, while impacted by overall economic performance, are driven by other factors. For instance, growth in the Utility Tax and Franchise Fee categories is typically more heavily impacted by rate changes than economic growth. Collections from local, State and federal agencies are driven by the grant and reimbursement funding available. Because these revenue sources do not track directly with the performance of the economy, they act as a buffer during an economic slowdown, easing the impact of a drop in the economically sensitive categories. Conversely, in times of economic strength, this can hold down the City's overall revenue growth.

BUDGET OVERVIEW

In the 2007-2008 Proposed Budget, the total net proposed funding is \$3.2 billion for all City funds (General, Special, and Capital). This is \$222 million or 7.4% above the 2006–2007 Adopted Budget (Table 2 below). This growth is entirely due to an 18.2% increase in the Capital Funds, which was the result of a substantial increase in the Airport Capital Program. As noted above, the total number of positions increased by approximately 1.9%, to a total of 6,970.

2007–2008 PROPOSED BUDGET — ALL FUNDS			
(Table 2)			
	2006–2007 Adopted	2007–2008 Proposed	% Change
General Fund	\$ 956,829,159	\$ 896,224,134	(6.3%)
Special Funds	1,326,725,177	1,743,116,173	31.4 %
<Less: Operating Transfers>	(645,998,184)	(1,029,795,496)	59.4 %
Net Operating Funds	\$ 1,637,556,152	\$ 1,609,544,811	(1.7%)
Capital Funds	\$ 1,383,338,546	\$ 1,633,453,222	18.1%
<Less: Capital Transfers>	(10,388,000)	(10,506,000)	1.1 %
Net Capital Funds	\$ 1,372,950,546	\$ 1,622,947,222	18.2%
Net Total	\$ 3,010,506,698	\$ 3,232,492,033	7.4%

The General Fund portion of the City's Budget would decrease by 6.3% from 2006–2007, and totals \$896.2 million. As always in the Proposed Budget, this is a somewhat misleading figure. Because the Proposed Budget is prepared two months before the end of the fiscal year, the numbers above do not include the additional funds that will be re-budgeted to complete multi-year projects.

2007–2008 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

Budget Balancing Strategies

Our earliest projections for 2007-2008 predicted a \$19.9 million shortfall of which more than ten percent (\$2.7 million) resulted from the use of one-time dollars to balance the 2006-2007 Operating Budget. After five consecutive years of having to close significant funding gaps, cost management controls that once seemed extraordinary are now integrated into the day-to-day operation of the City. In October, the City Council established a *2007-2008 Future Deficit Reserve* by setting aside \$6.4 million of year-end fund balances during the final reconciliation of the 2005-2006 Budget. The Cost/Position Management Plan imposed in December yielded an additional \$4.2 million in savings for the fund and translated to a 0.5% reduction for the Public Safety CSA and a 1.5% reduction for all other CSAs. In February, the Five-Year Forecast revealed a slightly improved picture with the projected General Fund shortfall dropping to \$16.2 million, primarily the result of refining the expenditure forecast. Further refinement of revenue and expenditure projections explained in detail later in this document resulted in a final General Fund shortfall in this Proposed Budget of \$16 million.

In preparing the 2007-2008 Proposed Operating Budget, the Administration was guided by a set of principles and strategies contained in the City Manager's Budget Request and adopted by the Council in the Mayor's March Budget Message. This Proposed Budget also responds to the 67 directives contained in the Mayor's March Budget Message with descriptions of how the budget responds to these referrals (Attachment B). A total of 3 of these directives will be responded to through the Manager's Budget Addenda process and additional detailed responses for another 25 directives will be brought forward to the City Council over the next year. A description of responses to the City Auditor's referrals is also included (Attachment C).

Two significant strategies used to balance this Proposed Budget were: 1) to focus reduction efforts on the elimination of vacancies; and, 2) to target the use of one-time funding to address the City's significant need to address infrastructure maintenance. Also, consistent with recent practice, funding for community-based organizations is proposed to be reduced by 4.7%, an amount equal to the average reduction for all non-public safety city service areas, partially offset by a 3% cost-of-living adjustment, for a net impact of 1.7%. The resulting 2007-2008 Proposed Budget recommends some ongoing cost reductions, necessary fee increases, and once again the strategic use of reserves. The table below shows the matrix of balancing strategies and the dollars associated with each action.

2007-2008 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

General Fund Budget Balancing Plan (Table 3)	
	In \$000s)
General Fund Shortfall	(16,004)
Fee Impact	(3,868)
TOTAL GENERAL FUND SHORTFALL	(19,872)
SOURCE OF FUNDS	
2007-2008 Future Deficit Reserve (one-time)	10,630
2006-2007 Fund Balance/Reserves	14,848
Development Fee Reserves/Fee Increases	6,137
Transfers from Other Funds	6,001
Miscellaneous	4,177
Total Change in Source of Funds	41,793
USE OF FUNDS	
Staffing & Non-Personal/Equipment Reductions	(9,219)
Funding Shifts	(2,428)
Use of Reserves (Committed Additions)	(2,150)
Technology & Capital Infrastructure Maintenance	18,804
Neighborhood Services Activities	3,906
New Facilities Operations & Maintenance	2,472
Economic Development Activities	2,100
City Council Direction (Mayor's Message)	1,415
Miscellaneous	7,021
Total Change in Use of Funds	21,921
Total Balancing Solutions	19,872

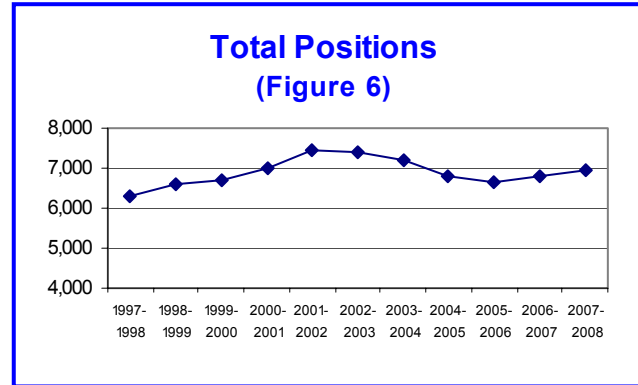
The stabilized economic picture has ameliorated the pressure to make profound reductions as a part of the 2007-2008 balancing plan, and provided the opportunity to strategically restore some positions. While that is good news, there are still real reductions and employee impacts in this proposal. As shown in the table below, recommended changes from the Forecast Base Budget level in the Proposed Budget would result in the elimination of 81 positions and the addition of 230 positions, for a net increase of 149 positions. The net change from last year, however, is only 127 positions, as 22 positions were eliminated in the Forecast Base Budget process as they were limit dated.

Changes in Position Count from Forecast to Proposed (Table 4)	
Reductions	(81.6)
Additions	230.3
Total	148.7

2007–2008 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

Of the positions recommended for elimination in the Proposed Budget, all but three should be easily accommodated, and staff will make every effort to find a redeployment opportunity for those three employees. As indicated earlier, the total number of positions would grow approximately 1.9% to 6,970 in 2007-2008. As Figure 6 demonstrates, even with the proposed additions, the total employee count is still only roughly equivalent to our 2000-2001 employee count. Since 2002 when the harshest impact of the economic downturn hit the City budget, the net reduction of City positions totals 448, a decline of almost 6%.



As has been true in other recent budget proposals, the 2007-2008 Proposed Operating Budget is balanced with assumptions about things that have yet to occur, but which could have significant impacts on this proposal. Among these are the as yet unknown cost of the Fire Arbitration decision, the rising costs of fuel, and anticipated support from the Redevelopment Agency. While \$750,000 remains in a Fuel Reserve set aside last year to address rising costs, volatility in fuel costs make it impossible to accurately project whether this amount will suffice. Budget discussions are ongoing with the San José Redevelopment Agency for several important projects, including Watson Park, North San José traffic mitigation, and necessary improvements at our convention center. Another area of concern is the possible impact of police overtime costs as this proposal anticipates support from downtown interests in assuming some financial responsibility for overtime incurred there.

City Service Areas

The following section highlights the most significant proposals for each of the City's six City Service Areas (CSA). A more detailed recitation of the proposals for each CSA can be found in the detailed budget pages following this message.

Community and Economic Development

San José continues to make strides in creating an environment that attracts and sustains driving industries. As a result, revenue and job growth are increasing, particularly in the innovative industries of biotechnology, nanotechnology and clean technology. In the current fiscal year there were several successes worth noting, including BEA relocating into Downtown, Nanosolar expanding into Edenvale, and several companies moving into North San José. As noted earlier, the Council-approved 3-year goals included a focus on increasing San José's economic vitality, and the Proposed Budget recommends a number of strategies to maintain fee programs at cost recovery, minimize service level impacts, and support necessary community and economic development initiatives.

2007–2008 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

Facilitate the development of safe, healthy, attractive, and vital communities – The City face significant revenue shortfalls in the development-related fee programs. At the same time, the CSA departments face the need both to prepare for compliance with newly adopted building codes and to make measurable improvements in the development process. Substantial increases in personnel costs such as retirement and health benefits have contributed to the fee program shortfalls. To close the gap and maintain service levels, this Proposed Budget would use \$3.4 million in fee reserves, impose modest fee increases, and make staffing adjustments. The proposed fee increases are for Building (5%), Planning (8%), Public Works (8.9%) and Fire (5%). The proposed staff adjustments would shift three positions from the Public Works capital program into the fee program to help meet project processing targets, eliminate 4.5 positions in Planning (3.5) and Fire (1.0), redeploy staff from General Fund to Planning and Building Fee programs, and fill eight positions – four temporary inspectors and four permit specialists – to hold processing times steady while existing staff are being trained on new building codes.

This proposal also contains key staffing additions to support essential community development services. Four temporary positions are recommended to complete the Comprehensive General Plan Update as directed by the City Council in the 2007-2008 Mayor's March Budget Message. The Update will revise the current plan adopted more than 13 years ago and address the significant growth issues facing the City. The Housing Department recommends adding two positions to manage its Asset Management and Housing Rehabilitation Programs, which provide community assistance for affordable and low-income housing. Both programs have seen increased activity due to declining resources for the Strong Neighborhoods Initiative and increased production of affordable housing units.

Strengthen the City's economic base to generate revenue and create jobs – To facilitate the expansion and relocation of driving industry companies and retail businesses in San José, the City is proposing one-time funding of \$1.0 million to establish an Economic Incentive Fund. This Fund would help create new jobs in San José by making incentives available for extraordinary and unanticipated development opportunities. Another \$300,000 is proposed for a Shopping Center Improvement Pilot Program that will earmark funds for façade improvements such as enhancements to signs, awnings, and landscaping. Finally, to continue raising the City's identity and garner exposure regionally, nationally, and internationally, this proposal recommends funding (\$150,000) as its half share of the total \$300,000 cost to continue the public relations work currently being conducted by Global Fluency. The Redevelopment Agency has been requested to match this funding.

Provide a diverse range of world-class events and cultural opportunities – Special events and festivals bring substantial visibility and economic impact to the City, and this budget proposal contains several recommendations that support existing venues or events as well as new programs. With a matching contribution from the Redevelopment Agency, this Proposed Budget would spend \$100,000 to hire a consultant to study appropriate uses for the Mexican Heritage Plaza and support the 2007 San José International Mariachi Festival. In its first year, the ZeroOne San José Festival had a local economic impact of \$9.0 million and furthered the City's goal of becoming a leading center for the creative intersection of art and technology. It also showcased the potential of the City Hall Rotunda as a

2007–2008 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

centerpiece for light works and artwork. Consequently, this proposal includes \$100,000 for a rotunda light projection program and \$200,000 in one-time funding for marketing and grant support for the next ZeroOne San José Festival.

These combined strategies – modest fee increases, strategic use of funding reserves, staff reductions and reallocations, funding reductions for non-public safety and obsolete programs, and investments in high return activities – will help the Community & Economic Development CSA achieve its short- and long-term goals related to economic growth and vitality for the City of San José.

Neighborhood Services

As noted earlier, the Council Priority Setting Session identified “*full funding for parks, pools, community centers and libraries, including maintenance, operation and development*” as one of its three-year goals, mirroring the recommendation of the Neighborhood Priority Setting Session a month earlier. In addition, the Neighborhood Leaders identified *Improve Proactive Code Enforcement* as one of their top priorities. In response to this clear direction, the Proposed Budget for the Neighborhood Services CSA attempts to achieve these goals by carefully allocating limited resources, minimizing service level impacts, and making strategic funding and staffing reductions or shifts.

Operate safe and clean parks, facilities and attractions – With strong demand for neighborhood services, several new parks and recreational facilities will open in 2007-2008. To staff and maintain these facilities, 12.55 positions are proposed to provide custodial and maintenance services (\$553,000). An additional, 11 positions would be added to address the maintenance needs of existing facilities, supported over the next three years by gradually drawing down on the \$7 million Enhanced Park Maintenance Reserve.

The single largest expenditure in this year’s Proposed Budget is the \$5 million in funding needed to clean up the Watson Park site. This money would be allocated to a remediation action plan contract to be awarded this summer. An additional \$2 million has been requested from the San José Redevelopment Agency to fully restore the park to pre-existing condition, including open turf areas, a soccer bowl, dog park, a play lot, and other amenities.

Provide vibrant cultural, learning and leisure opportunities – In support of the Community Center Re-Use Plan, this budget proposal includes \$1.25 million, with \$379,000 for the Northside Community Center (7.2 positions), to continue current services until a qualified non-profit operator is found. The 15 positions funded with the remaining \$871,000 would be shared between the Alma Senior Center, Hank Lopez Youth/Community Center, St. James Senior Center, and a contract/property management team for all Re-Use sites. Also, this budget would partially restore the Summer Aquatics program for the 2008 summer season, as directed by the City Council.

While the Community Centers will see staff additions, this CSA will see significant reductions, as well, with 4.5 Library positions and 17.75 Parks, Recreation & Neighborhood Services (PRNS) positions recommended for elimination. All of these have been vacant since at least July 2006. While this realizes nearly \$1.3 million in cost savings, it precludes any increase in service levels to the

2007–2008 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

community. Service areas impacted by these reductions include gang intervention, strategic support and some maintenance areas in PRNS, and direct customer service at branch libraries. Despite reductions, the CSA continues to evaluate, redesign and consolidate programs to meet community needs. The Work Experience Program will save \$103,000 by placing youth in City departments only in the summer session as opposed to year-round. PRNS will explore other strategies and partnerships with the Human Resources Department to continue workforce preparation services.

Ensure healthy neighborhoods and capable communities –Proactive code enforcement to identify and resolve issues affecting neighborhood quality is clearly a priority for the City's communities. This proposal adds two positions (\$233,000) to provide enforcement and field inspections for certain blight conditions. With these two positions, it is estimated that 1,400 of these conditions such as junk vehicles stored in driveways, overgrown and dead weeds, and improper storage of appliances, could be identified and resolved during 2007-2008. Code Enforcement is also proposing to increase both the Multiple Housing and Solid Waste Fees, by 4.3% and 8.7 % respectively. In addition to bringing these fee programs to full cost recovery, this action would enable the division to replace aging computers and printers and support overtime costs for the Neighborhood Clean-Up Program. As noted earlier, a reduction equal to the average reduction of all non-Public Safety CSAs is proposed for community based organizations which in this CSA would equate to a \$323,000 reduction to groups such as the San José Conservation Corps, Youth Science Institute, and Outreach VTA.

In conclusion, this Proposed Budget focuses resources where the community desires them and avoids major impacts to service levels. The demand for neighborhood services will always be high and this proposal attempts to strike a delicate balance between that demand and available resources so that it can continue to achieve its goals.

Public Safety

According to Community Budget Priority Setting Sessions, Public Safety remains a top priority among San José residents, and the City Council, likewise, has made clear its commitment to maintaining a strong Public Safety core. Police, Fire and the Office of Emergency Services have maximized limited resources to ensure overall safety, effectiveness and efficiency. However, increased demands from expanding service areas, a growing population and prior budget reductions have impacted service. The Proposed Budget would add 15 additional police officers, provide staffing for one new fire station, and continue temporary funding for an expanded San José Prepared! to recruit and train community volunteers.

As directed in the Mayor's March Budget Message, 15 new sworn police officers are recommended (\$1.7 million) to help meet identified priorities in the Police Department. This addition may result in some improvements in response time to Priority 1 calls and property crimes resolution. Also proposed is the restoration of a police communications manager position, eliminated three years ago, to support the daily management, quality assurance, and training functions in the Communications Division. In the area of school safety staffing, the reallocation of less than two out

2007–2008 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

of 41 vacant crossing guard positions to a School Safety Coordinator should support the restoration of crossing guard service to all but five of the intersections covered by the program. Since this position was eliminated in the current year budget, service levels have declined because of backlogs in hiring, training, and supervision. In the area of Police overtime, earlier this year the Administration added \$800,000 to the Police overtime budget to address downtown safety. With this proposal, only half of that amount (\$400,000) would be ongoing. Consistent with City Council direction in the Mayor's March Budget Message, the Administration will work with downtown interests where large overtime costs are incurred to mitigate the impact of this reduction.

Fire Station 34 (Berryessa) comes online at the start of the fiscal year and will be temporarily staffed by personnel from Station 2 (Alum Rock), which will be remodeled during 2007-2008. Funding is recommended for an additional Firefighter Recruitment Academy (\$470,000), so that the new fire station will be fully staffed next year when the Station 2 remodel is completed. The temporary relocation of resources from Station 2 to Station 34 during Station 2's remodel will enable the Department to test an alternative EMS response configuration that if successful could significantly improve EMS and fire suppression delivery efficiency. A new Battalion Chief would also be added to oversee the Fire Department's special operations training program for airline emergencies, confined space rescues, low angle rescue and high rise rescue. The \$176,000 cost would be funded with a corresponding reduction in overtime for special operations.

Transportation and Aviation

As noted earlier, the telephone poll conducted as part of the new community budget prioritization process rated traffic congestion, street maintenance and pothole repair as leading issues of public concern. While the sustained economic downturn has challenged the departments tasked with providing safe, secure and efficient surface and air transportation systems, they continue to pursue a series of innovative and aggressive initiatives to advance San José's livability and economic vitality.

The surface transportation system – some 2,300 miles of streets – has been significantly underfunded over the last five years, despite an almost 12% growth in infrastructure assets, such as pavement, lighting, and landscaping. This has exacerbated the City's estimated \$459 million one-time street infrastructure maintenance backlog and a \$20-30 million annual shortfall. Given the need in this area, the proposed budget does add seven Capital-funded positions in the Pavement Maintenance program and designates \$5 million in one-time funds to address the most immediate infrastructure maintenance needs.

Proposed Budget impacts are reflected in the elimination of such programs as sidewalk repair grants and NASCOP (Neighborhood Automated Speed Compliance Program), which in turn eliminates four filled and one vacant position. Similarly, a recommended proposal to convert \$1,035,909 from ongoing to one-time funding would eliminate ten tree maintenance positions at the end of 2007-2008, resulting in the shift of funding for Street Tree Maintenance to property owners starting in 2008-2009. The elimination of the remaining Sidewalk Repair Program, except for hardship cases, would save \$560,231 on an ongoing basis.

2007–2008 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

Ten capital-funded positions would support the growing workload associated with the North San José Development and local transportation projects and ensure active City participation in the design and delivery of regional transportation projects, such as the BART extension, Route 101 improvements, and the 280/880/Stevens Creek upgrade. An example of a strategic investment aimed at developing long-term solutions to our immediate challenges is the City's ongoing Strategic Transportation Maintenance Master Plan effort. This community engagement process effort will confirm needs, community priorities and funding alternatives – and is critical to identifying community support for alternative funding options that will be needed for sustainable maintenance of transportation assets.

The Airport has achieved remarkable success with the approval and ongoing delivery of the \$1.5 billion Terminal Area Improvement Program (TAIP), approval of the new Airline Signatory Agreement, and completion of major airfield reconstruction projects. Implementation will continue in 2007-2008. However, the air transportation system continues to face a sustained economic challenge, typified by passenger traffic levels that remain roughly 20% below the peak levels of 2000-2001. In 2007-2008, a modest 2.5% growth rate is projected.

Nonetheless, the cumulative affect of required resource reductions has resulted in significant impacts to customer service levels and deferred maintenance. Recognizing the importance of reversing this trend, airlines have agreed to a multi-year rate increase of approximately 125%, of which 70% will take place in 2007-2008. Overall rates and charges are being compared with other airports, and adjustments recommended where justified. New concession contracts for a variety of services, including advertisement, food and beverage, retail, rental cars, luggage carts, and business service centers are being pursued as opportunities to raise revenues as well as bring improvements to customer service. Uses of the former FMC property (Airport West) will be explored as a key resource for developing the Airport's west side, with the potential reconfiguration or relocation of parking to provide land for enhanced cargo or general aviation use. This can generate new revenue which can be devoted to customer service and deferred maintenance.

For both surface and air transportation systems, the 2007-2008 Proposed Budget reflects the City's continued commitment to fiscal management by scaling back certain services as needed to match resource limitations. Simultaneously, however, this CSA is also moving aggressively to pursue enhanced revenues as well as legislative and grant programs wherever viable.

Environmental and Utility Services

The City's large utilities, which are based in this CSA, have a national reputation for providing proactive and innovative environmental services. Each utility is based on an enterprise model that values financial sustainability and cost recovery, stakeholder involvement, and regional partnerships with agencies in the public and private sectors.

2007-2008 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

Recycle Plus, the City's solid waste utility, will be implementing new service agreements with several companies this July that provide garbage, recycling and yard trimmings services plus street sweeping. The new agreements, signed after an extensive competitive bid process, will cost the City and its ratepayers approximately \$15 million above last year's costs while three continuing contracts will add another \$1 million in increased costs. Although partially offset by a \$2.1 million reduction in non-contractual expenditures, a 28% rate increase for single-family households and a 4% increase for multi-family households has been recommended by the Administration to generate \$18 million additional revenues and maintain cost recovery. A public hearing will be held May 8.

Chief among the water-related utilities is the *San José/Santa Clara Water Pollution Control Plant* which, coupled with the City's *Sanitary Sewer System*, protects public health and the environment by transporting wastewater from homes and commerce through some 2,200 miles of pipelines and a network of pump stations and facilities to the Plant for treatment and discharge. Similarly, the *Storm Sewer System* protects homes and commerce from flooding by diverting runoff flows into local waterways through another massive network of pipelines, pump stations, and outfalls.

Portions of these three sewer systems, however, need major repairs or replacement. This year the Plant celebrated its 50th Anniversary with an outstanding record of awards and innovations. However, the longevity we celebrated this year is a double-edged sword for the future. A recent engineering report, for example, identified \$1 billion in infrastructure needs at the Plant over the next 15 years. A total of \$167 million in Water Pollution Control Plant construction projects are included in the 2008-2012 Proposed Budget. To address this challenge, the transfers to the capital funds are being increased by approximately \$25 million over 2006-2007 levels. Significant projects in the five-year Plant CIP include electrical system reliability (\$58 million), and piping and equipment related to the Plant's digester system (\$20.4 million). To assist in preventing neighborhood sewer backups, two specialized trucks for cleaning sanitary sewers are recommended as replacement equipment.

Major projects in the five-year Storm Sewer CIP include drainage improvements in Alviso and continued storm pump station rehabilitations. To fund these capital improvements as well as additional staffing for improved infrastructure management, preventive maintenance and watershed enforcement projects among others, the Administration is recommending residential rate increases of up to 9% for 2007-2008 in both the Sewer Service and Use Charge Fund and Storm Sewer Operating Fund. An increase of up to 10% is proposed for commercial, industrial and institutional users of the storm water system. Because rates paid by commercial, industrial and institutional users of the sanitary system vary based on their chemical composition and other factors, the proposed increases would vary from 3% up to 15%. In April, the City issued public notices to alert the public to these critical needs, the proposed rate increases for 2007-2008, and the potential for additional increases the next two years as well.

The cost of purchasing potable water from two local wholesalers, which are themselves addressing infrastructure issues, is driving the need for rate increases of up to 12% for all customers served by the *Municipal Water System*. Other factors behind the proposed increase include rising energy costs necessary to operate water wells and pump water to higher elevations in certain areas; rising

2007–2008 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

chemical costs for treating drinking water; higher fuel costs; ongoing infrastructure maintenance costs; labor-related costs, and compliance with more stringent state and federal water quality regulations. Likewise, increases of up to 14 cents per hundred cubic feet are proposed for water deliveries from *South Bay Water Recycling*, which is used for industrial processes and turf or agricultural irrigation by 180 San José customers.

Finally, two positions are recommended to further the City Council's aggressive support for green building and LEED goals and expand the City's Energy Efficiency Program. With one position funded by PG&E energy rebate dollars, the net General Fund impact would be \$201,000 and will help San José achieve significant cost savings through better management of natural resources.

Strategic Support

Reductions in four of the past five years have had a cumulative effect on services provided by the Strategic Support CSA. Cuts to staffing and reduced resources have limited each department's ability to deliver key services to City residents. This Proposed Budget includes recommendations to restore some of the most critical needs.

As noted earlier, fully one-third of the City's workforce will be eligible to retire within the next five years and a workforce planning effort is already underway meet that challenge. Three temporary positions, which were added at the 2006-2007 Mid-Year Budget Review, are proposed to be continued with a limit date of June 30, 2008. These positions will allow permanent staff to focus on recruitment, classification and compensation activities to fill vacancies faster at the cost of \$309,000.

The City of San José will continue to 'contract-in' City services when possible and economically feasible. This budget anticipates bringing a portion of its plumbing and electrical services in-house, providing a higher level of service with a \$169,000 reduction of costs.

To meet the increasing complex requirements of the Americans with Disabilities Acts (ADA) the Proposed Budget would add a full time ADA coordinator (\$142,000) to address accessibility issues in City-owned facilities. In addition, a temporary Senior Analyst position would be converted to permanent status (\$126,000) to coordinate the Return to Work Program, ensuring the City's compliance with requirements to provide reasonable accommodations to injured employees.

In July, 2006, the Integrated Billing System (previously called C-UBS) "went live." In support of this major effort, the Customer Service and Recycle Plus call centers were consolidated and shifted to the Information Technology Department. During the current year, 19 temporary positions were added to address Customer Contact Center performance issues. To ensure that improved service levels continue, funding of \$1.3 million is proposed to make 11 of those positions permanent and continue eight as date-limited positions. Also included in this proposal is the addition of 8 Finance and Information Technology positions (\$946,000) to address critical financial & technology needs such as account maintenance & technical oversight to continue full implementation of Phase I of this project.

2007-2008 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

The Revenue Collections Strategic Plan pilot program instituted in 2006-2007 would continue with the addition of five support staff positions, three of which are temporary. With the addition of these positions, investigators will be free to focus on collections efforts rather than administrative duties. The \$1.1 million generated by the new collection program will more than offset staffing costs.

In order for Public Works to effectively support the multi-year construction of the Airport Terminal Area Improvement Project, a total of 9 new positions, ranging from accountants to landscape architects, must be added. Public Works is also proposing the addition of three other positions, two real property agents (\$205,000) and a Contract Compliance Specialist (\$88,796.) The real property agents will support Parks and Transportation property-related activities. This includes sports fields master plan, aquatics study and facility re-use, as well as Measure A Highway projects and BART. The positions will offer increased support to property transfers, right of way issues and regional transportation projects such as Measure A Highway projects, BART and the Guadalupe Corridor. The Contract Compliance Specialist, which will be fully supported by the Redevelopment Agency, will monitor agency contracts for compliance with Prevailing and Living Wage policies.

Funding is proposed to support a major update of the City's Standard Specifications and Details for Construction Projects (\$350,000). This project is expected to save time and money for staff, contractors and consultants. The last update was in 1992. The current plan leads staff to devote a significant amount time to developing 'workaround' strategies when existing plans and specifications are outdated. This slows the process down for everyone. The cost of the proposal is expected to be repaid to the General Fund over the course of ten years by the Public Works Program Support Fund and the Public Works Development Fee Program.

In 2006-2007, the City invested much needed capital in information technology, assessing our current business applications and systems. This will continue in 2007-2008 with an investment of \$5.5 million. The proposed funds include \$3.5 million for various technology uses such as establishing a test lab, hardware for GIS applications, upgrades to the CAD system and assistance/training. An additional \$2 million is recommended to renew the Technology Reserve. Lastly, the remaining \$2 million from the 2006-2007 Technology Reserve will be used to replace existing network equipment at the Police Department Campus. This is a one-time cost and will address the accumulating problems with the Department's current leased system.

The synchronization of the Public Works Sanitary Sewer Geographic Information Systems (GIS) and the Department of Transportation's Infrastructure Management System (IMS), a \$130,000 project, will give maintenance staff access to the latest data and route maintenance crews more efficiently. This saves both money and time, resulting in faster completion of repair projects.

The proposed budget includes a one-time \$1.3 million cost for a secondary cooling system for the City Hall Network Operations Center. This will provide protection for equipment housed in the Operations Center in the event of failure of the primary cooling system.

2007–2008 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

This budget proposes a \$250,000 reduction to the Vehicle Maintenance and Operations Fund Ending Fund Balance. In addition, while a \$150,000 reduction to the \$1.75 million allocation for General Fleet Replacement is recommended, the remaining \$1.6 million represents a significant increase over most recent years when spending on non-public safety vehicles was frozen. Replacing aging fleet vehicles saves money and benefits San José's commitment to a green economy.

The City of San José is committed to recognizing its employees, as well as generating home-grown innovations and creative ways to deliver service. The organization's ability to continue to achieve high performance levels in the face of five years of reductions is a testament to the continued hard work and dedication of our workers. With the GASB 43/45 induced focus on retirement health costs raising understandable concerns in the workforce, we are committed to engaging employees in meaningful discussions about how to address this issue, as well as in identifying ideas to improve operations and reduce costs. In addition to meeting with the City Labor Alliance, holding facilitated employee forums, and establishing a suggestion box program, we will be exploring a gain sharing program and having employees lead benchmarking trips to other jurisdictions. While some employees may feel burdened by yet more reductions, it is important to note that in the Proposed Budget new positions actually outnumber proposed reductions. The employee driven Employee Values Project identified recognition as one of our core values. The Administration embraces this with the recommendation in the 2007-2008 Proposed Operating Budget to create a \$100,000 city-wide Innovation Fund. The funds would be used to implement innovative ideas from City employees for increasing revenues, reducing costs or improving service delivery. An Innovation Team, comprised of representatives from Human Resources, Information Technology, Finance and the Budget Office, would oversee the program.

For Strategic Support, the proposed 2007-2008 budget continues the steady restoration of key services and the investment in improving how we do business.

Capital Improvements — Investing in the City's Infrastructure

The recently released 2007-2008 Proposed Capital Budget is substantial, accounting for approximately one-half of the City's total Proposed Budget. Now in the second half of the *Decade of Investment*, the city's Capital Improvement Program (CIP) continues to transform San José's public infrastructure. The capital investments proposed over the next five years are significant with a 2007-2008 Proposed Capital Budget of \$1.63 billion and a 2008-2012 Proposed CIP of \$2.75 billion.

The growing list of new facilities coming online joins the significant backlog of unmet infrastructure needs and deferred maintenance to place increasing demands on the City's strained budget. The Administration is developing a comprehensive assessment that identifies and prioritizes the City's infrastructure needs and develops funding strategies to address the backlog. In addition, operating and maintenance costs for new facilities scheduled to open over the five-year period continue to be a concern.

2007–2008 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

Major Capital Investment Highlights

Mineta San José International Airport — Improvements in the Proposed CIP totals \$1.5 billion and includes recommendations based on the recent amendments to the Airport Master Plan approved by the City Council in June 2006. The CIP represents efforts that incorporated input from a variety of stakeholders in order to develop a facility that would meet the community and customers needs while keeping costs low.

Parks, Libraries, and Public Safety Facilities — In 2000 and 2002, voters approved General Obligation Bond measures to support library projects (\$212 million), parks projects (\$228 million), and public safety facilities (\$159 million). As previously reported to the City Council, escalating construction and real estate costs continue to cause concern for the City. In the area of sports fields, the Administration is committed to returning to the City Council before the end of this calendar year with the results of a community engagement process designed to finalize locations for these important city assets. The City expects to complete all of the remaining bond projects in the next five years and the Proposed CIP released in April allocates a combined \$312 million in these Bond funds for these purposes.

Utility Infrastructure — Significant investments in the City's utility infrastructure are ongoing, including the expansion of the water and sanitary sewer systems. The \$89 million Reliability Improvements project at the Water Pollution Control Plant is scheduled for completion in October 2007, ten months ahead of schedule. This Proposed CIP includes \$248 million for improvements to address unmet infrastructure needs including Electrical Reliability improvements totaling \$58 million over the next five years.

Green Building — In an effort to position the City as a leader in sustainable design and set a community standard of environmental, economic, and social stewardship, the City Council adopted revisions to the City's Green Building Policy in March 2007. The Proposed CIP includes projects that were underway under the adoption of the new Policy that will strive to achieve new green building standards.

Public Art — Recent revisions to the Public Art Master Plan, approved by the City Council on March 13th of this year, are designed to reinforce San José's urban design and development goals in an effort to create opportunities for public art in high-traffic locations. A total of \$8.1 million is programmed for public art projects in the 2008-2012 Proposed CIP. Previously, the public art allocations were spread only among the Airport, Civic Center, Public Safety, Library, Municipal Improvements, and Parks and Community Facilities Capital Programs. As part of the changes to the Master Plan, the Traffic, Parking, Sanitary Sewer, Storm Sewer, Communications, Water Utility System, and Water Pollution Control Capital Programs, now also contribute to public art.

2007–2008 PROPOSED BUDGET MESSAGE

BUDGET OVERVIEW (CONT'D.)

Unmet Infrastructure Needs

As the Council well knows, a large backlog of unmet infrastructure needs exists in areas such as transportation and information technology, vehicle replacement, and maintenance at City parks and building facilities. The total needs were estimated at approximately \$445 million with the annual ongoing funding requirement to keep that infrastructure maintained estimated to be approximately \$20-25 million.

In addition to the large outstanding needs for which the General Fund would need to be the primary or partial funding source, significant needs remain for the City's various Special Fund programs. For example, as part of an Infrastructure Condition Assessment prepared for the Environmental Services Department in February 2007, critical replacement needs for the Water Pollution Control Plant totaled \$249.4 million in the first five years and \$996.8 million of total capital infrastructure needs. Funding for a Plant Master Plan (\$6 million) is included in the five-year CIP which would provide the City with a phased program of recommended wastewater treatment facilities and management programs to accommodate planned growth and meet existing and future regulatory requirements.

A detailed work plan for the reduction of deferred maintenance and infrastructure backlog for the City's facilities is currently underway. In August 2007, staff will present the Transportation and Environment Committee with a compilation of existing condition assessments and recommendations for proceeding with strategy development.

CONCLUSION

This 2007–2008 Proposed Operating Budget successfully closes a \$16 million dollar shortfall primarily with ongoing reductions, but also with the strategic use of reserves, one-time dollars, and with fee increases designed to maximize cost recovery in a number of areas. We believe the mix of solutions represents a sound approach to balancing the budget. As we did last year, we have been able to minimize the use of one-time solutions, which brings the added benefit of minimizing future year shortfalls. While a number of vacant positions have been eliminated, the impact on the existing workforce has been minimized, and we have been able to strategically add positions to meet critical needs. While the list of unmet needs in the area of infrastructure maintenance remains long, we have been able to set aside significant dollars to begin addressing the substantial backlog that continues to grow. We have maintained our commitment to provide essential services, adding resources in the Public Safety CSA, and have maintained the City Council's commitment to neighborhoods. This plan maintains the sound financial discipline that has allowed us to manage through the long recession.

I want to express my respect and admiration for the City workforce, which continues to impress me with its strong commitment and high degree of professionalism. My appreciation also goes out to all of the dedicated City employees who have worked closely with the Administration as we moved through this budget process. In particular, I want to acknowledge and express my sincere

2007–2008 PROPOSED BUDGET MESSAGE

CONCLUSION (CONT'D.)

appreciation to the many employees at all levels of the organization, but most especially the administrative staff in City departments as well as the entire Budget Office, who work countless hours and contribute so much to the preparation and production of this budget document. Finally, I want to thank Larry Lisenbee who retires with this Budget. For 21 years he has helped the City of San José navigate treacherous financial waters as our Budget Director. The City organization and all of San José's residents owe him a deep debt of gratitude.

A handwritten signature in black ink, appearing to read "Les White", with a long horizontal flourish extending to the right.

Les White
City Manager

2007–2008 PROPOSED BUDGET MESSAGE

Appendix 1 Unmet Needs List

UNMET/DEFERRED INFRASTRUCTURE AND MAINTENANCE NEEDS

Infrastructure/Maintenance Area	Estimated Cost*
General Fund Needs	
1. Transportation Infrastructure	\$ 391,514,000
2. Information Technology Infrastructure	3,978,000
3. Vehicle/Equipment Replacement	3,025,000
4. General Services Maintenance	1,166,000
Subtotal of General Fund Needs	\$ 399,683,000
Potential Use of Other Funds to Partially Fund	
1. Parks Facilities	\$ 29,664,000
2. General Services Maintenance	11,670,000
3. Convention & Cultural Facilities*	4,290,000
Subtotal Potential Other Funding Sources	\$ 45,624,000
TOTAL	\$ 445,307,000

* Team San José assessment list is not comprehensive.

NEW AND UNFUNDED INITIATIVES/PROGRAMS

Unfunded Initiative	Estimated Cost*
1. GASB 43/45	\$98,000,000
2. Police Staffing Plan	20,200,000
3. General Obligation Bond Projects	18,200,000
4. Watson Park	7,900,000
5. City-wide Aquatics Plan	7,400,000
6. Trees-Maintenance and Enforcement	3,850,000
7. Open Government Initiatives/Reed Reforms	2,000,000
8. Network Operations Center Back-Up Cooling	1,300,000
9. Night Shift Custodial Services at City Hall	1,200,000
10. Shopping Center Improvement Pilot Program	1,200,000
11. General Plan Update	820,000
12. Mexican Heritage Plaza	700,000
13. Small Business Bonding Program	250,000
TOTAL	\$163,020,000

* Represents 2007-2008 costs to fully fund initiative on desired schedule, where possible.